Supreme Court, U.S.
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No. 96-322

In the Supreme Court of the United States

OCTOBER TERM, 1996

NACHREINER BOIE ART FACTORY,
NANCY NACHREINER AND THOMAS NACHREINER,

Petitioners,

v.

THOMAS E. GORIS, THE NORTHWESTERN MUTUAL LIFE INS. CO., MICHAEL J. SLUTZKY AND DANIEL J. STEFFEN,

Respondents.

On Petition for a Writ of Certiorari to the Wisconsin Court of Appeals

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

ANDREW L. FREY*
KENNETH S. GELLER
JOHN J. SULLIVAN
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, DC 20006
(202) 778-0602

**Counsel of Record*

QUESTIONS PRESENTED

1. Whether the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461, preempts state-law claims of fraud in the inducement and misrepresentation arising in connection with (but before the adoption of) an employee benefit plan.

2. Whether a majority (51%) stockholder of a corporation is an "employee" for purposes of ERISA.

RULE 29.6 STATEMENT

Respondent, The Northwestern Mutual Life Insurance Company, has the following subsidiaries (other than wholly owned subsidiaries): MGIC Investment Corporation, The Grand Avenue Corporation, and Baird Financial Corporation. The latter are indirect subsidiaries.

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BRIEF FOR THE RESPONDENTS IN OPPOSITION

The petition in this case raises two issues decided by an intermediate appellate court in Wisconsin, neither of which merits review by this Court. The first issue -- whether the Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001-1461 ("ERISA"), preempts state-law claims of fraud in the inducement and misrepresentation arising in connection with (but before the adoption of) an employee benefit plan — is largely academic here because the vast majority of the misrepresentations alleged by petitioners occurred *after* the adoption of the benefit plan in this case. Moreover, putting aside this glaring factual and pleading impediment, the decision below is consistent with the decisions of this Court, the federal courts of appeals are now moving toward a uniform view on the question, and the Wisconsin Supreme Court has yet to address the issue on the merits. There is plainly no need for review by this Court of the decision in this case.

The second issue raised by petitioners — whether a majority (51%) stockholder of a corporation is an "employee" for purposes of ERISA — is even less worthy of review. The exception to ERISA established for *sole* proprietors and *sole* stockholders has never been applied to a majority stockholder by any court, state or federal. Petitioners offer no reason why this Court should reach out to decide an issue that was correctly decided by an intermediate state appellate court and that has generated no confusion — indeed, not a contrary precedent — in the lower courts. The petition should be denied.

STATEMENT

1. Petitioner Nachreiner Boie Art Factory, Ltd. ("Art Factory") purchased from respondent The Northwestern Mutual Life Insurance Co. ("Northwestern") a series of life insurance policies for certain employees as part of a benefit plan established by Art Factory. Pet. App. 5a. The first policy was issued under the plan in April 1984 to petitioner

Thomas Nachreiner, who owned 51% of the stock and was president of Art Factory. Under the terms of an Agreement between Art Factory and Nachreiner, dated April 1, 1984, Art Factory purchased from Northwestern a policy insuring Nachreiner, and Art Factory agreed to pay the policy premiums. The excess cash value accrued under the policy "was to be the source of retirement income for Mr. Nachreiner." *Ibid.* The Agreement between Nachreiner and Art Factory provided that it was "'intended to qualify as a life insurance employee benefit plan'" and was "'intended to meet the requirement[s] of Employee Retirement Income Security Act of 1974.'" *Ibid.* Nachreiner was designated the "plan fiduciary" under ERISA. *Id.* at 6a.

Over the next several years, Art Factory entered into virtually identical agreements with three other employees, each providing life insurance issued by Northwestern that "was intended to provide a source of retirement income benefits and life insurance protection." Pet. App. 6a. For example, Nachreiner's wife, petitioner Nancy Nachreiner, who was a bookkeeper for Art Factory, received an insurance policy from Northwestern in September 1985 under an agreement with Art Factory that "was almost identical to her husband's, containing the same recitals regarding the nature of the plan, and providing for a plan fiduciary and a claims procedure." *Ibid.* Charles Boie, a co-owner (49% of the stock) and a director of Art Factory along with Thomas Nachreiner, executed a similar agreement with Art Factory in November 1985 providing employee benefits, including an insurance policy issued by Northwestern. *Ibid.*; Pet. 5. And Thomas Stocki signed a similar agreement with Art Factory in November 1986 under which he received a life insurance policy issued by Northwestern and paid for by Art Factory. Pet. App. 7a.

2. Petitioners were sued in the Circuit Court for Milwaukee County, Wisconsin in December 1992 by some former business partners. Pet. 3-4; Pet. App. 3a-5a. In

response, petitioners cross-claimed against respondents, Northwestern and three individual Northwestern agents, alleging various state-law causes of action related to the insurance policies issued by Northwestern under Art Factory's employee benefit plan. Petitioners' cross-claims included fraudulent and intentional misrepresentation, negligent misrepresentation, negligence, negligent supervision, breach of contract, breach of implied contract, and interference with business relations. *Id.* at 30a-38a.

Respondents moved for summary judgment on petitioners' cross-claims, arguing that they were preempted by ERISA, which "supersede[s] any and all State laws insofar as they may now or hereafter relate to any employee benefit plan * * *." 29 U.S.C. § 1144(a). The trial court granted the motion and dismissed petitioners' claims against respondents as preempted, finding "that they do relate to an ERISA plan." Pet. App. 17a-18a.

Although the underlying action involving petitioners and their former business partners was settled, petitioners appealed the dismissal of their cross-claims against respondents. Pet. App. 5a.

3. In the Wisconsin Court of Appeals, petitioners abandoned all of their claims against respondents except the "fraud in the inducement and misrepresentation" claims. Pet. App. 7a, 34a-35a. The heart of petitioners' case, as described by the Court of Appeals (*id.* at 7a), was an allegation that respondents had made fraudulent statements to petitioners over the course of seven years while issuing insurance policies under Art Factory's employee benefit plan. Thus, petitioners' cross-claim alleged (*id.* at 34a):

> In the years 1984 through 1991, [respondents] * * * made certain false and fraudulent representations to Thomas Nachreiner, Nancy Nachreiner or Art Factory concerning the policies wherein the [respondents] stated to Thomas Nachreiner, Nancy Nachreiner or Art

> Factory that Art Factory was a business suitable for the plan funded through the policies and that the shareholders of Art Factory were eligible to benefit from that plan; that the [respondents] structured the plan for Art Factory which would be funded through the policies * * *.[1]

Petitioners urged the Court of Appeals to reverse the trial court's preemption decision on three grounds. First, petitioners claimed that "ERISA preemption is inapplicable because the Art Factory purchased four separate policies, which were not part of an 'employee benefit plan.'" Pet. App. 10a. Second, they argued that, even if the policies constituted a "plan," the "misconduct" by respondents "occurred prior to the time the policies were issued and, therefore, their cross-claims about that misconduct do not 'relate to' any ERISA plan." *Ibid.* Third, the Nachreiners asserted "that because Mr. Nachreiner is a 51% owner of the Art Factory, they are not 'employees' under ERISA and,

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[1] Petitioners alleged, among other things, that respondents stated they were "experts in planning for and achieving high investment returns for businesses such as Art Factory by obtaining tax advantages and special benefits available only to small business owners," that the insurance policies issued under Art Factory's employee benefit plan were "essentially investment contracts which would receive preferential federal and state tax treatment," and that the insurance policies "were a simple means of investment planning which required virtually no complex administration and would produce superior economic results in comparison to alternative investment or retirement plans." Pet. App. 34a-35a.

Petitioners further alleged that these representations by respondents were knowingly false when made and that petitioners "relied upon the[se] representations, and thereby were induced to purchase and did purchase continue *[sic]* the Art Factory policies and paid the [respondents] substantial sums of money." Pet. App. 35a.

therefore, that ERISA does not preempt their state law cross-claims." *Id.* at 12a.

The Court of Appeals rejected these arguments. First, the court held that "the four policies constitute an 'employee benefit plan.' They were all paid for by the Art Factory and funded by [Northwestern] policies, and all were intended to secure retirement benefits and insurance coverage." Pet. App. 10a. Moreover, "[t]he express terms of the agreements and disclosure statements demonstrate that each policy was to be part of an employee benefit retirement plan in compliance with ERISA." *Ibid.*; *id.* at 12a n.4.

Second, the court concluded that petitioners' fraud in the inducement and misrepresentation claims were preempted by ERISA. Following the reasoning of courts that have "reject[ed the] 'pre-plan' argument against ERISA preemption," the court held that petitioners' claims "relate to" the employee benefit plan adopted by Art Factory. Pet. App. 11a-12a. The court disagreed with the analysis of decisions that have found no preemption of "pre-plan" misrepresentations claims, concluding that "the reasoning of the case law adhering to a broader interpretation of 'relates to' is more persuasive given Congress's effort to provide ERISA with wide preemptive power." *Id.* at 11a n.3.

Third, the court held that Mr. Nachreiner's 51% ownership interest in Art Factory did not change his status as an "employee" for purposes of ERISA. Pet. App. 13a-14a. The court distinguished cases holding that "sole proprietors or sole shareholders" are employers and observed that "[t]he Nachreiners have not cited, and we have not located any case law establishing that a 51% owner" of a corporation is an employer whose claims are not subject to ERISA. *Ibid.*

The Court of Appeals therefore affirmed the judgment of the trial court. Pet. App. 14a. Petitioners sought review of all three issues in the Supreme Court of Wisconsin, which denied their petition. *Id.* at 2a.

REASONS FOR DENYING THE PETITION

1. Petitioners ask this Court to decide "whether conduct which occurs prior to the sale of an insurance policy 'relates to' an ERISA plan [and is therefore preempted] even though the plan does not then exist." Pet. 6. Petitioners contend that this case involves fraudulent statements and misrepresentations by respondents *before* the adoption of an ERISA plan by Art Factory. *Ibid.* And they assert both that there is "a conflict among the circuits" over the question whether "pre-plan" claims of fraud are preempted and that the Wisconsin Court of Appeals — which found such claims preempted — answered that question incorrectly. *Ibid.* In addition, petitioners suggest that the decision below "appears to conflict" with this Court's decision in *New York State Conference of Blue Cross & Blue Shield Plans* v. *Travelers Ins. Co.*, 115 S. Ct. 1671 (1995).

a. The threshold problem with the petition on this issue is that petitioners' factual allegations are not readily squared with the legal question they now seek to raise in this Court. Petitioners have consistently argued in the courts below that respondents made fraudulent statements concerning each of the *insurance policies* issued by Northwestern. Moreover, they have maintained throughout the litigation that there was no single employee benefit "plan" of which the insurance policies were a part. Instead, petitioners assert that there were simply four separate insurance policies issued by Northwestern and that, at most, each policy constituted a separate ERISA "plan."

Indeed, petitioners state at the outset of their petition to this Court "that they were induced to enter into *each of the[] [Northwestern insurance] policies* as a result of misrepresentations made to them by [respondents]." Pet. 5 (emphasis added). They have alleged in particular that over the course of seven years — from "1984 through 1991" (Pet. App. 34a) — respondents "made certain false and fraudulent representations to [petitioners] * * * *concerning the policies*

wherein the [respondents] stated * * * that Art Factory was a business suitable for the plan funded through *the policies* * * *" (*ibid.* (emphases added)).

In short, petitioners' state-law claims for fraud in the inducement and misrepresentation are predicated on the allegation that respondents made "false and fraudulent" statements in connection with the sale over several years of *each of the insurance policies* issued by Northwestern. And petitioners vigorously disputed in the trial court and on appeal that there was a single "plan." Pet. for Review at 18-19 ("[t]he [Northwestern] defendants argue that there is only one plan here, but that is simply not true"). They argued to the Wisconsin Supreme Court in their petition for review that "[t]here were four separate policies sold" and "that these were four separate plans as [Northwestern] uses the word. Each plan had a different name. Each plan related to only one policy of insurance." *Id.* at 19.

The insuperable problem for petitioners now is that the Wisconsin Court of Appeals conclusively resolved this issue against them, finding that there was only one plan: "the four policies constitute an 'employee benefit plan.'" Pet. App. 10a.[2] Petitioners' request for review of this determination by the Wisconsin Supreme Court was denied (Pet. App. 2a) and they have not sought review in this Court of that plainly case-specific determination. Petitioners are therefore bound by the ruling below that there was one ERISA "plan" — comprised of the four insurance policies. And this "plan" was adopted no later than April 1, 1984, when the first agreement was executed by Thomas Nachreiner and Art Factory and provided for the issuance of an insurance policy by

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[2] This determination is completely consistent with the allegation in petitioners' cross-claim that the alleged misrepresentations in this case concerned "the *plan funded through the policies*." Pet. App. 34a (emphasis added).

Northwestern. That policy, in turn, was dated April 3, 1984. See pages 1-2, *supra*.

The conclusive determination by the courts below that there was only one ERISA "plan" adopted by Art Factory severely undermines petitioners' state-law tort claims because virtually all of the allegedly fraudulent statements and misrepresentations by respondents occurred *after* the adoption of the "plan" in early April 1984. Indeed, petitioners have never specified any particular statement by any one of the respondents that occurred before April 1, 1984, and they effectively concede that there were no fraudulent statements at all by respondents before 1984. Pet. App. 34a. Instead of focusing on "pre-plan" conduct by respondents before April 1984, petitioners have chosen to focus on alleged "pre-policy conduct" over the course of seven years.

These concessions and pleading deficiencies are fatal to petitioners' argument that ERISA does not preempt their state-law claims, because they have previously conceded — as they must — that claims based on misrepresentations and fraudulent statements made *after* the adoption of a plan are preempted by ERISA. See *Farr* v. *US West, Inc.*, 58 F.3d 1361, 1366 (9th Cir. 1995) ("state law claims challenging fraudulent statements about the nature of a benefits plan itself are preempted by ERISA") (citing cases); see also *Anderson* v. *Humana, Inc.*, 24 F.3d 889 (7th Cir. 1994); *Pohl* v. *National Benefits Consultants, Inc.*, 956 F.2d 126 (7th Cir. 1992); *Washington Nat'l Ins. Co.* v. *Hendricks*, 855 F. Supp. 1542 (W.D. Wis. 1994). In fact, before the Wisconsin Court of Appeals, petitioners themselves distinguished those "cases holding that fraud in the inducement claims are preempted by ERISA in situations where a plan is already in existence. As a result, those claims relate to a broader course of conduct and dealings between the parties. That is not so here." Reply Br. of Defendants-Appellants at 3. Here, petitioners argued, there was no "plan," only "four separate policies

sold." *Id.* at 4. But the Wisconsin Court of Appeals rejected this argument and that determination is final and conclusive.

It is now too late for petitioners — who litigated this case on the premise that respondents made fraudulent statements before the insurance *policies* were issued — to change horses. They litigated and lost in the courts below the question whether each policy was a separate "plan." Now in this Court, they try to avoid the consequences of that decision by blurring the distinction between "pre-plan" and "pre-policy" conduct. They argue that there is an important legal question brewing in the lower courts over whether state-law claims based on fraudulent statements made before a "plan" was adopted are preempted by ERISA. Their cross-claims in this case, however, are not premised on allegations of "pre-plan" fraud. Their claims are premised, at bottom, on allegations of "pre-policy" fraud occurring after the ERISA plan was adopted.

In sum, even if this Court were to agree with petitioners that state-law claims of fraud in the inducement and misrepresentation arising before an employee benefit plan was adopted are not preempted by ERISA, petitioners would not benefit from that holding because their claims against respondents are premised on the faulty notion that each insurance policy in this case was a separate plan. Petitioners have not identified any specific fraudulent statements or misrepresentations by any of the respondents before the actual "plan" in this case — as opposed to the individual policies — was adopted. The question presented is therefore academic and its disposition by this Court would not affect the substantial rights and liabilities of the parties to the case.

b. Even if the question sought to be raised by petitioners were not hypothetical, the decision below on ERISA preemption does not merit review. First, the decision petitioners challenge was rendered by an intermediate Wisconsin appellate court. Because the Wisconsin Supreme Court declined to grant review, the decision below does not

represent a judgment on the merits by that Court and is therefore not the final word on the issue even within the State of Wisconsin. See *Southern Cross, Inc.* v. *John*, 193 Wis.2d 644, 647, 533 N.W.2d 188, 189-190 (1995) ("discretion" of Wisconsin Supreme Court in reviewing petitions for review is "similar to that exercised by the United States Supreme Court when dealing with writs of certiorari" and denial of petition "does not establish the law of the case nor amount to res judicata on the points raised"); *Wisconsin* v. *Johnson*, Nos. 95-0266-CR, 95-0382-CR, 1996 Wisc. App. LEXIS 56, at *4 (Wisc. Ct. App. Jan. 18, 1996) (noting that conflicts among the decisions of the Wisconsin Court of Appeals "are becoming increasingly common").

Second, the decision below is entirely consistent with this Court's decisions on ERISA preemption. Under 29 U.S.C. § 1144(a), federal law "supersede[s] any and all State laws insofar as they may now or hereafter relate to any employee benefit plan * * *." Congress' purpose in preempting state law under this section was "to establish pension plan regulation as exclusively a federal concern." *Pilot Life Ins. Co.* v. *Dedeaux*, 481 U.S. 41, 46 (1987) (quotation marks omitted). And in interpreting the ERISA preemption provision, this Court has held that the words "relate to" must be given their "broad common-sense meaning" and that a law "relates to" a plan if it has "a connection with or reference to * * * a plan." *Id.* at 47 (quotation marks omitted). State common law claims are included within the scope of the preemption provision. *Id.* at 48; see *Metropolitan Life Ins. Co.* v. *Taylor*, 481 U.S. 58 (1987).

Here, petitioners' claims, by their own admission, "relate to" the employee benefit plan adopted by Art Factory. They assert that "the way to compute damages in the Nachreiner claims is to subtract the benefits promised from the benefits actually received" under the plan. Pet. 11. By computing damages in this manner, however, petitioners

directly affect the amount of benefits that will be paid under the plan. This is not a case like *New York State Conference of Blue Cross & Blue Shield*, 115 S. Ct. at 1678-1680, where the Court held that state statutes of broad general applicability were not preempted by ERISA because they had only a speculative and indirect effect on the costs of health care services offered under certain ERISA plans. In the case of Art Factory's plan, by contrast, petitioners' state-law tort claims (if proven) would directly affect the benefits actually available under that ERISA plan.

Third, the conflict in the circuits cited by petitioners is, in fact, narrowing. Of the four circuits identified by petitioners, only the Eighth Circuit now appears to hold that pre-plan fraud and misrepresentation claims are preempted, see *Consolidated Beef Indus., Inc.* v. *New York Life Ins. Co.*, 949 F.2d 960, 964 (1991), cert. denied, 503 U.S. 985 (1992). And the Eighth Circuit — which gave the issue only cursory attention as an alternative to its primary holding that the plaintiff's claims related to whether the employee benefit plan at issue "was properly administered" (*ibid.*) — based its ruling on the Eleventh Circuit's decision in *Farlow* v. *Union Cent. Life Ins. Co.*, 874 F.2d 791, 794 (1989). The Eleventh Circuit, however, recently overruled *Farlow*, see *Morstein* v. *National Ins. Servs., Inc.*, 93 F.3d 715 (1996) (en banc), and joined the Fifth and Sixth Circuits in finding "pre-plan" fraud and misrepresentation claims are not preempted by ERISA. See *Perkins* v. *Time Ins. Co.*, 898 F.2d 470 (5th Cir. 1990); *Perry* v. *P*I*E Nationwide, Inc.*, 872 F.2d 157 (6th Cir. 1989), cert. denied, 493 U.S. 1093 (1990). Whether or not these decisions are correct — and respondents continue to believe they are not — there is not at the present time the kind of circuit split that warrants review by this Court.

In sum, the division in the circuits identified by petitioners is diminishing and may well disappear without this Court's intervention. There is no need for the Court to reach out to review an intermediate state court opinion on the issue,

particularly in a case that is supported by a dubious factual predicate.

2. The second issue raised in the petition is clearly meritless. Petitioners assert that because Thomas Nachreiner owns 51% of the stock of Art Factory, he "and his wife * * * are not 'employees' under ERISA. Since the owner and his wife are not 'employees' under ERISA, there is no preemption and the state courts have jurisdiction over all of the [petitioners'] state common law claims." Pet. 12. The Wisconsin Court of Appeals rejected this argument as unsupported by any precedent. Pet. App. 12a-14a. Moreover, petitioners' assertion is flatly contradicted by the terms of the agreement between Art Factory and Mr. Nachreiner, which specified that it was "'intended to qualify as a life insurance employee benefit plan'" and was "'intended to meet the requirement[s] of Employee Retirement Income Security Act of 1974.'" Pet. App. 5a.

Under ERISA, "[a]n employer cannot ordinarily be an employee or participant" in an ERISA plan. *Giardono* v. *Jones*, 867 F.2d 409, 411 (7th Cir. 1989). Therefore, "[o]nce a person has been found to fit within the 'employer' integument, ERISA prohibits payments to him from a qualified plan." *Kwatcher* v. *Massachusetts Serv. Employees Pension Fund*, 879 F.2d 957, 960 (1st Cir. 1989). The statute defines an "employer" as "any person acting directly as an employer, or indirectly in the interest of an employer, in relation to an employee benefit plan * * *." 29 U.S.C. § 1002(5).

The Department of Labor has adopted a regulation that interprets this provision to exempt from ERISA coverage certain employees who wholly own the businesses in which they are employed. 29 C.F.R. § 2510.3-3(c)(1) ("[a]n individual and his or her spouse shall not be deemed to be employees with respect to a trade or business * * * which is *wholly owned* by the individual and his or her spouse"). Consistent with this regulation, the federal courts have

uniformly held that *sole proprietors* and *sole stockholders* are "employers" and not "employees" for purposes of ERISA. See, *e.g.*, *Meredith* v. *Time Ins. Co.*, 980 F.2d 352, 353-358 (5th Cir. 1993); *Kwatcher*, 879 F.2d at 958-961; *Peckham* v. *Board of Trustees*, 653 F.2d 424, 427 (10th Cir. 1981); *Kelly* v. *Blue Cross & Blue Shield of Rhode Island*, 814 F. Supp. 220, 226-227 (D.R.I. 1993).

Petitioners seek to overcome this unbroken line of cases by citing "a series of partner cases," in which a "partner was deemed to be the employer and could not be considered an employee under ERISA." Pet. 14 (citing *Harper* v. *American Chambers Life Ins. Co.*, 898 F.2d 1432 (9th Cir. 1990); *Robertson* v. *Alexander Grant & Co.*, 798 F.2d 868 (5th Cir. 1986), cert. denied, 479 U.S. 1089 (1987)). Applying the "logic" of the "partner cases," in which "by definition, a partner has to be a partner with someone else" (Pet. 14), petitioners argue that Mr. Nachreiner, as a 51% stockholder, is in effect a "partner" with his fellow stockholder (*id.* at 14-15).

Petitioners' "logic" is faulty because partners and stockholders are *not* treated the same in fact or in law for ERISA or for many other purposes. In particular, the Department of Labor has adopted a regulation (29 C.F.R. § 2510.3-3(b), (c)(2)) providing that "ERISA does not apply to retirement plans which cover only partners." *Simpson* v. *Ernst & Young*, 850 F. Supp. 648, 664 (S.D. Ohio 1994); see *Harper*, 898 F.2d at 1433; *Robertson*, 798 F.2d at 870-871. In the corporate setting, however, the Department exempts only *sole stockholders*. See 29 C.F.R. § 2510.3-3(c)(1); page 12, *supra*. In light of these precedents, the court below found that petitioners' reference to the partnership exemption from ERISA was not "particularly instructive." Pet. App. 14a n.7.

At the end of the day, petitioners cite no case in which a court treated a stockholder — other than a sole stockholder — as an "employer" for purposes of ERISA. In fact, the

lower court decisions are uniform in finding the "employer" exception applicable only to sole proprietors and stockholders. Petitioners offer no plausible reason why this Court should grant review and disturb these settled precedents. The petition should therefore be denied.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ANDREW L. FREY*
KENNETH S. GELLER
JOHN J. SULLIVAN
Mayer, Brown & Platt
2000 Pennsylvania Ave., N.W.
Washington, DC 20006
(202) 778-0602

**Counsel of Record*

OCTOBER 1996